Seminar Paper No. 482

THE SWEDISH EXPERIENCE

by

Assar Lindbeck

INSTITUTE FOR INTERNATIONAL ECONOMIC STUDIES
Stockholm University
Seminar Paper No. 482

THE SWEDISH EXPERIENCE

by

Assar Lindbeck

Seminar Papers are preliminary material circulated to stimulate discussion and critical comment.

December 1990

Institute for International Economic Studies
S-106 91 Stockholm
Sweden
THE SWEDISH EXPERIENCE*

by Assar Lindbeck

The growth performance

Sweden was a latecomer to the process of modern economic growth. However, when the industrialization process in Sweden finally began around 1870, it was relatively rapid. From 1870 to 1950 the per capita GNP growth rate in Sweden seems to have been the fastest in the world (Lindbeck, 1975 p.2). As a result, Sweden probably ranked among the three richest countries in the world in 1950. (Bairoch, 1976; Maddison, 1979; Summers and Heston, 1984.) The ranking in terms of private consumption was probably similar. Thus, the relatively high level of affluence in Sweden during the course of the post war period can be regarded basically as an accumulated result of successful economic growth performance during the preceding eighty-year period. This is a very important observation: the advanced welfare state experiments in Sweden after World War II were undertaken only after nearly a century of exceptionally successful economic growth.

The main lesson from the eighty year experience 1870-1950 is

* I am grateful to Magnus Dahlquist for research assistance and to Anders Björklund, Lars Calmfors, Carl B. Hamilton and Walter Korpi for very useful comments to a draft of the paper.
probably that a liberal economic regime, with a "small government", and with a traditional division of responsibilities between the private sector and the government, may be quite conducive to economic development. By a "traditional" division of responsibilities I mean, of course, that private firms are in charge of production and distribution of goods and services (including banking), without much government intervention, while the government is in charge of the rules of the game, the supply of truly collective goods, and most of the physical infrastructure, and to a considerable extent also education, health care and social security. However, good luck also helps -- such as having been spared two world wars.

During the course of the eighty year period 1870-1950, government spending gradually increased from less than 10 per cent of GNP at the end of the 19th century to about 25 per cent in 1950 and 31 per cent in 1960 -- all figures close to the average for Western Europe and North America. It was not until the 1960s that the size of public spending in Sweden started to depart substantially from other western countries. In 1970 public spending in Sweden had reached 43 per cent of GNP, as compared to the OECD average of 32 per cent; and during the 1980s the Swedish figure hovered above 60 per cent, as compared to the OECD average of 40-45 per cent (OECD statistics).\footnote{It should be noted that figures like these only provide a very broad picture of the the extent to which the government budget directs income flows. For instance, in some countries certain transfer payments received by households are taxed while in other countries they are not (and hence can be kept at lower levels with similar distributional effects); in some countries (such as Sweden) families with children are supported by child allowances (transfer payments) while in other countries they are supported by tax deductions, etc. Moreover, "internal transactions within the public sector are not always counted in the same way in all countries. In some countries, including Sweden, net expenditures of the consolidated public sector are smaller than actually recorded figures of public sector spending due to large flows of funds between municipalities and the central government.}
government plays a very insignificant role on the production side in Sweden; for instance, in the manufacturing sector government ownership has hovered between 5 and 10 per cent of value added (and employment).

What then are the main lessons from the specific Swedish experience during "the large-government period" after the 1960s? It is useful to organize the discussion of this issue around three basic features of Swedish economic policy in this period as compared to other highly developed countries -- each feature being an important driving force behind the exceptionally rapid expansion of government spending in Sweden.

First, "full employment policies" have been pursued more systematically, and indeed more successfully, in Sweden than in most other OECD countries, with open unemployment fluctuating in the interval 1-3 per cent of the labor force even during the 1980s when unemployment in Western Europe as a whole was about 10 per cent, before it fell to about 7 per cent in the late 1980s.

Second, the ambitions to create economic security and to redistribute income have been more pronounced, and probably also more successful, than in most other OECD countries -- mainly by way of transfer payments, social security systems and progressive taxation. Also labor union policy has been strongly egalitarian.

Third, relatively large resources have been devoted to the production and administration of government services to households, i.e., "public consumption", which has had important implications for the division of labor between markets, the family and the government.

The main purpose of the paper is to discuss these three characteristic features of the Swedish economy. However, by way of introduction, it is useful to sketch, though only very schematically, the
relative Swedish growth and productivity performance during the post World War II period, and the consequences of this for the level of per capita income and consumption today as compared to other OECD countries.

Generally speaking, overall income and productivity growth in Sweden in the post World War II period has not been particularly fast, by contrast to the previous eighty years. For instance, per capita GNP growth was about 0.4 percentage points slower per year in Sweden than the (unweighted) OECD average between 1950 and 1990, even if we exclude from the statistics Japan (as being very poor in 1950) as well as four (relatively fast growing) low-income countries in Southern Europe (Greece, Portugal, Spain and Turkey). (OECD 1990c; see also Korpi (1990) Table 2)

As a result of these developments, while per capita GNP in Sweden in 1970 was still some ten per cent above the OECD average, the country seems to have dropped down to about the OECD average in 1990 (figures based on purchasing power parity calculations; OECD 1990a.) Sweden's ranking in terms of per capita GNP today seems to be somewhere between fifth and tenth place among OECD countries.

Sweden's lag is more pronounced in terms of private per capita consumption (hence excluding "public consumption"). If OECD statistics on these matters are taken at face value, Sweden would, in fact, have slipped to a level somewhere around twelfth place among OECD countries, 14 per cent below the OECD average -- as compared to fifth place, rather close to the OECD average, in 1970. (OECD, 1990a p. 146) The position is even lower in terms of per capita disposable income, as household saving is exceptionally low in Sweden. In 1988, for instance, real disposable
income of workers in manufacturing in Sweden seems to have wound up at about nineteenth place among OECD countries (Lindbeck (1988c)).

There are, of course, serious statistical problems connected with comparisons like these. One factor that tends to bias the GNP figures for Sweden upwards (level as well as growth rate), as compared to other countries, is that nowadays many services which elsewhere are produced mainly within the household, such as child care and old age care, are produced largely by the public sector in Sweden, and hence are included in the Swedish GNP figures. A more adequate measure of aggregate labor productivity would therefore be GNP per hour of labor input. Unfortunately, there are no comprehensive figures available today of this. It is of some interest to note, however, that while during the period 1973-1988 Sweden lagged by only about 0.1 percentage point per year in terms of per capita GNP growth as compared to the OECD average (Japan but not the poorest countries in Southern Europe being included), the lag was about 1 percentage point per year in terms of GNP per employee. (Korpi 1990 Table C)

Another important upward bias in the Swedish GNP figures is that the rate of increase in labor productivity in the public sector is schematically assumed to be zero in the national accounts, while empirical studies suggest that there has rather been a negative productivity trend. For instance, available studies suggest that labor productivity fell by about 1.5 per cent per year in the public sector in Sweden during the 1970s. (SCB, 1990, chapt. 10)

It is also of interest to look at the manufacturing sector, where the measurement problems are usually regarded as less severe. We then

---

2 Calculations on the basis of The Tax/Benefit Position of Production Workers, 1985-89, (1989); and National Accounts 1960-88 (1990), OECD.
observe that the yearly labor productivity growth rate (value added per hour) from 1973 to 1990 has been about 1.3 percentage point slower in Sweden than the OECD average. (Nordin 1990).

On balance, these figures suggest a relatively slow rate of labor productivity growth in Sweden since about 1970. It is sometimes argued that "inevitable" technological and organizational "catch-up" of countries with lower per capita income than the technologically leading counties, to which Sweden belonged in 1950, is the basic reason why productivity growth in Sweden during the post World War II, was slower than the OECD average. However, this cannot possibly be the whole explanation, as the growth rate in Sweden was relatively slow not only in the 1950s, but also in the 1970s and 1980s (in particular in the second half of the 1970s and the second half of the 1980s), i.e., after most (or even all) of the technological catch-up must have been completed.

While the figures for per capita GNP gives an upward bias of the overall productivity of Sweden, there is a downward bias in the Swedish statistics for disposable income and private consumption. The reason is that in some other countries, the fees for (private) pensions and various types of economic insurance are recorded as parts of disposable income and private consumption, while the corresponding fees in Sweden usually consist of taxes.

Nevertheless, it is quite safe to conclude that Sweden no longer belongs to the richest among the OECD countries in terms of private disposable income and private per capita consumption (excluding public consumption).

---

3 This is the main point in, for instance, Korpi (1990). Dowrick and Nguyen (1989) have tried to make a systematic, though rather mechanical, catch-up study by way of regression analysis for the period 1950-1985.
Obviously, even "unbiased" figures, however, for private consumption and household disposable income would not provide a full picture of the standard of living, and far less, the "quality of life" of the population. For instance, partly as a result of high marginal tax rates Swedes choose to take, and supposedly enjoy, more leisure than people in most other OECD countries (although the economic evaluation of leisure should then be calculated on the basis of after-tax wage rates for households rather than on the basis of pre-tax wage costs for firms). For instance, while full-time employees in most OECD countries work about 1,750-2,000 hours per year (2,200 hours in Japan), the corresponding figure in Sweden is about 1,650 hours. (OECD 1990d, Table 1.4.)

Country comparisons should also include services to households that are recorded in the national accounts as "public consumption" (such as education, health care, child care, old age care, etc). While public consumption in Sweden is 27 per cent of GDP, typical figures for other OECD countries are about 15-20 per cent. On a per capita basis measured public consumption seems, in fact, to be about 60 per cent higher than the OECD average (OECD 1990a).

Unfortunately it is not clear by how much the earlier mentioned figures for private consumption should be amended by the inclusion of such public sector services. One reason has already been mentioned: in some countries such services are provided mainly by the household. Another reason is that "public consumption", which is measured from the cost side, rather than from the consumption side, is not exposed to "market tests". It is therefore an open question how households actually evaluate such services. Indeed, it is not obvious that, for instance, health care, education and old age care are (much) "better" in Sweden than in other OECD countries. (If official statistics for "public
consumption", calculated at cost, are added to private consumption, the ranking of "total consumption" in Sweden would become rather close to Sweden's ranking in terms of per capita GNP.)

Most observers visiting Sweden will probably be surprised by statistics like the ones presented above about private consumption and disposable income. The "appearance" of affluence in Sweden is probably higher than indicated by these figures. One reason is that a country that recently was ahead of other countries can enjoy (statistically unrecorded or underestimated) services from the previously accumulated capital stock, such as housing, durable consumer goods and public infrastructure (including the city environment). Such services tend to lag GNP figures when an economy starts to grow either faster or slower than before. (As other examples, fast growing Japan gets relatively low services from its lagging housing stock; and the city environment of Buenos Aires still "looks" relatively rich, though the national accounts tell us that per capita income is quite low.) Another reason why affluence in Sweden still looks quite high for a visiting observer, walking the streets, is probably that private consumption is relatively evenly distributed.

Employment policies

Let us return to the three initially mentioned "specific features" of the Swedish post World War economy, starting with employment-promoting policies. Why has unemployment been so low in Sweden during the last two decades (more specifically after the mid-seventies) as compared to most other OECD countries, in particular the EC countries? My interpretation is the following.
When unemployment tended to increase substantially in Sweden in the mid-seventies, in the connection with the oil price shock, the international recession and a domestic "wage cost explosion", potentially unemployed workers were "mopped up" by the public sector. For instance, permanent (ordinary) public sector employment (excluding public sector corporations and public utilities) increased from 21 per cent of the labor force in 1970 to 30 per cent in 1980 (measured as the number of employees), and has subsequently stayed at about that share. Temporary labor market programs also expanded substantially. As a result, at the bottom of the recession in 1978, about 8.5 per cent of the labor force was either openly unemployed (2.5 per cent), engaged in various temporary government labor market programs, such as public sector relief work or public sector training programs (2.7 per cent), engaged in part-time employment in the public sector (youngsters 17-20 years of age, amounting to about about 0.3 per cent of the labor force), or had withdrawn from the labor force through early retirement for labor market reasons (3.0 per cent). (Calmfors and Forsslund, 1990, p. 74.)

While large-scale early retirement for labor market reasons occurred also in some countries on the European continent (such as Belgium and Holland), the total "package" of government organized labor market programs were clearly more important in Sweden than in other countries.

Meanwhile, the contraction of private sector employment was mitigated by means of government subsidies. By far the most important support program was the subsidies to declining industries, such as ship-building and steel. These amounted to as much as 2.5 percent of GNP during the second half of the 1970s (IUI 1981, p.25), but were largely phased out after the devaluations in 1981/1982.
In addition to such selective measures to boost private sector employment there was also a devaluation of the krona by 10 per cent in 1977 (against a basket of goods), which resulted in a significant reduction in the real exchange rate and of unit labor costs relative to other countries.\(^4\)

Employment policies were different in the eighties. Tendencies toward increased unemployment were now counteracted mainly through two devaluations (in 1981 and 1982) by altogether about 28 per cent, which again reduced the real exchange rate and relative unit labor costs. Moreover, substantial devaluations against the D-Mark (by some 25 per cent) continued after 1982 when the Swedish krona was pegged to a basket of currencies. Selective labor market programs and subsidies to private firms played a much smaller role than in the 1970s.

These attempted explanations of low unemployment in Sweden is not to deny that the highly advertised "active labor market policies" may also have contributed to the relatively low unemployment figures.

However, I would play down the importance of such programs as compared to the role of the expansion of permanent public sector employment, selective subsidies to firms and devaluations.

This is suggested already by the size of the increase in permanent public sector employment relative to the temporary labor market programs. Moreover, the important role played by the devaluations is indicated by the strong reversals of the trend in private sector employment immediately after devaluations. Econometric microeconomic studies also cast some doubt on the often asserted strong positive employment effects

---

\(^4\) There were also reductions in the value of the Swedish krona in October 1976 and April 1977 by altogether 9 percent. However, those adjustments only restored the effective exchange rate against a basket of currencies to the position in the beginning of 1976.
of publicly financed retraining programs. While some studies suggest that the probability of a worker getting a job, in a long-run perspective, is enhanced by such training programs, other studies have not found any such effects (Björklund 1990). However, even if retraining may not have contributed much to aggregate employment, it seems that retraining has helped people to get somewhat higher wages than they would otherwise.

Moreover, there are strong indications that public sector employment programs only temporarily reduce unemployment. For instance, available macroeconomic studies suggest that the wage-reducing effects of a contraction of employment in the private sector are largely wiped out if increased open unemployment is fought by placing potentially unemployed people into various types of public sector labor market programs. In fact, if existing macroeconomic studies are taken at face value, open unemployment may in a long-term perspective, even have been raised by some of the labor market programs actually pursued in Sweden, by pushing up the real product wage substantially in the private sector. (Calmfors and Forslund, 1990, chapt. II; and Calmfors and Nymoen 1990)

However, it is reasonable to hypothesize that the limited duration of the Swedish unemployment benefit system, and the strict way the system is administered, has mitigated the unemployment-creating effects that tend to be a consequence of all unemployment benefit systems. More specifically, workers may be cut off from unemployment benefits in Sweden if they refuse to take offered jobs or to join offered training programs. The Swedish experience also suggests that it is probably useful to connect administration of the unemployment system with labor market exchange and training systems (regardless of whether the latter are
publicly or privately operated). One indication is that the relation (ratio) between the number of unemployed and the number of vacancies has not increased during the 1980s, by contrast to most other countries; i.e. the so called "Beveridge curve" has not shifted to the right, in spite of increased benefit levels and greater coverage of the unemployment benefits system.

However, regardless of which of the various elements of Swedish economic policy have been responsible for the low unemployment level, the success in preventing a large increase in unemployment in the late seventies and early eighties has, most likely, helped avoid the emergence of persistent long-term unemployment and possibly also "time dependency" of the unemployment rate (so called hysteresis). From this point of view, attempts to prevent unemployment from increasing sharply, to begin with, may be worthwhile even if the costs of preventing increased unemployment would be heavy.

What then are these costs? They probably do not consist mainly of the government spending that is required to operate various labor market programs, as the alternative, i.e. to accept high open unemployment, is likely to incur even higher costs for society. The costs of Swedish-type employment policies are more complex. For instance, recurring devaluations steepen the inflation trend, resulting in arbitrary redistribution of income and wealth, partly because everybody has not the same ability to protect himself against inflation. A high and rather unpredictable rate of inflation also generates distortions in the allocation of resources, partly because the tax system is nominalistic. Recurring discrete devaluations also mean that a period of an increasingly overvalued currency is abruptly replaced, after a devaluation, by a period of an undervalued currency, with recurring
reallocations of resources, back and forth, between the tradable and the non-tradable sector as a result. There is also a great risk that during periods of overvalued currencies (before a devaluation) politicians will resort to highly selective subsidies to firms.

Serious problems are also connected with fighting unemployment by way of increased public sector employment during recessions. In particular, if permanent (ordinary) public sector employment expands during periods of unemployment tendencies, it will be difficult, or even impossible, to reverse the policies later on. As a result, more resources than "desired" may in the long run be absorbed by the public sector.

A highly controversial issue in Sweden is the role of centralized wage bargaining for wage formation. Indeed centralized wage bargaining, without government involvement (and without the rights of local strikes after the centralized agreements), has often been regarded as the essence of "the Swedish model". The basic hypothesis is then that such a bargaining system results in moderation in the wage demands, in order to prevent various types of negative macroeconomic externalities of wage increase, such as induced product price increases, aggregate unemployment, high taxes to finance unemployment benefits, etc.

I am sceptic about this argument. First, the degree of centralization of wage bargaining in Sweden is often exaggerated, in particular by foreign observers, as about half the yearly wage increase takes place via so-called "wage drift", including formal or informal bargaining at the level of individual firms. Second, in the context of Swedish-type "centralized bargaining", there are nowadays about three independent organizations on each side, each of which is engaged in
separate bargaining. This makes centralized "cooperative solutions" difficult to achieve.

Moreover, if it had really been the case that centralized, or perhaps rather "semi-centralized" bargaining results in "responsible" wage increases, why then have yearly nominal wage increases been so large that the government has, from time to time, been forced to step in afterwards with discretionary devaluations, to "correct" the consequences for real product wages? In other words, if centralized, or quasi-centralized, bargaining is so conducive to responsible wage formation as is sometimes asserted, why have the nominal wage changes not been more modest in Sweden?

The most favorable thing that may be said about the semi-centralized bargaining in Sweden is perhaps that it has not prevented, and may even have helped, recurring devaluation from temporarily reducing the real product wage for a number of years -- until nominal wage inflation has moved relative unit labor costs back to "Square one".

I would also suggest that the notion that a country can "choose" between centralized and decentralized bargaining may be a misspecification of available alternatives. Assuming that "wage drift" cannot be eliminated, the issue rather seems to be at how many levels bargaining should be conducted. If all bargaining is decentralized to the level of individual firms, bargaining will (by definition) be conducted at just one level. If instead wage bargaining is highly centralized, we would expect bargaining to occur at two or three levels - - the central level, the firms level, and possibly also at an intermediate level (of industrial branches).

I would hypothesize that total nominal wage increase is likely to be larger if wage formation takes place on two (or even three) levels
than if it occurs on just one level. In this sense, centralized bargaining may very well be counterproductive for ambitions to keep down the rate of nominal wage increase, as well as the level of the real product wage -- in spite of often-heard assertions that central bargaining is likely to take care of various negative externalities of nominal and real wage increases.

There is another, in my judgement even more important, weakness of centralized bargaining. In such a system, the central union leadership can exert political blackmail vis-à-vis the government. The unions can ask for various political favors for themselves as a requirement for their willingness to accept wage moderation. Examples are privileges of striking and picketing against "third agents", rights to enforce unionization in nonunionized firms, various tax-financed subsidies to unions (such as tax deductability of union membership fees) or even a tax-financed takeover of the ownership of shares in private firms by the unions (an idea pursued by the Swedish unions in the 1970s).

However, even if centralized bargaining cannot perhaps be recommended, it is probably true that a climate of consensus, in the sense of shared values, which does exist in Sweden to a considerable extent, is conducive to a peaceful labor market.

Redistribution policies

The Swedish experience also suggests that welfare state policies may, indeed, be very successful in creating economic security and also in equalizing the distribution of yearly disposable incomes (Lindbeck

---

5 Thus, Mancur Olson and others, who have argued that a centralized union, which might internalize the externalities of their actions, have forgotten that the union may force the government to pay a price to the union for implementing this internalization.
Among observers with egalitarian preferences, this must be regarded as a major achievement. However, there is a snake in every paradise. In this case the snake is the total marginal tax schedule. In the eighties, when total tax revenues amounted to 50-55 per cent of GNP, marginal tax rates were in the interval 70-80 per cent for most income earners if all types of explicit and implicit taxes are included - income taxes, value-added and consumption taxes, the tax implicit in the connection to income-dependent transfer payments, and the "pure" tax component of the payroll tax (i.e., the nonactuarial component of the fees that finance the social security system). (Lindbeck 1983.)

One important reason for these very high rates of taxes in Sweden is that the dominating ideology of social policies has been to avoid selective support of poor people. The philosophy has been that everybody, regardless of income, should enjoy transfer payments and subsidies -- to avoid "stigmatization" of help from the public sector. This is the background for the so-called "Generalized Welfare State Policy" in Sweden.

There are well-known disincentive effects of such high marginal tax rates. The most obvious example is probably the substitution effect from labor supply (in the market sector) to leisure and do-it-yourself work, such as the maintenance of houses and durable consumer goods. In the Swedish case, however, this effect is counteracted by the fact that increased public spending to a considerable extent consists of public

6 There is hardly any evidence that the progressive tax and transfer system has been "shifted" to a more uneven distribution of factor incomes, as the distribution of factor incomes, too, has become more even in Sweden during the post World War II period, up until the early 1980s. This observation is consistent with macroeconometric studies of wage formation, according to which income tax increases in a long run perspective do not seem to influence the real product wage rate of firms, but only the real after-tax consumption wage (Calmfors and Nymoen, 1990).
sector services that are close substitutes for household service production, mainly by women, such as child care and old age care (in addition to education and health services). As a consequence, the negative substitution effects of higher marginal tax rates on aggregate labor supply in the open market have been mitigated by public sector provision of services to households. This counteracting effect is reflected largely in the high labor force participation rates of married women, mainly in the form of part-time work.

However, other types of public spending programs have accentuated the negative substitution effect on labor supply. One example is the health insurance system, which has given strong incentives for absenteeism from work. Indeed, Swedes are on the average absent from work about 24 days a year for reported illness (in 1989), as compared to about 10-12 days in "typical" OECD countries. People also obtain legal financial compensation for staying home for studies, taking care of sick relatives, mainly children, or even visiting their children at day care centers. This high absenteeism, as compared to other countries, is partly also a consequence of the high labor force participation rates of married women, who are "double workers" (household work and market work) and who often stay home to take care of sick children.

These are some of the reasons why the number of hours of work per year of full-time employees is relatively low in Sweden. However, the relatively high labor participation rate of married women means that the number of hours of market work per capita of the entire population in productive ages (20-65 years of age) is not particularly low in Sweden as compared to other highly developed OECD countries; indeed, it is close to the average for this group of countries.
An increase in early retirement in recent years, amounting to about 7 per cent of the labor force (measured as the "stock"), is another illustration of reduced labor supply as a result of the social security systems. Indeed, the total number of "absentee days" per employee (including leave for work-related injuries, long-term sick leave and early retirement) is no less than 50 per year. (Riksförsäkringsverket)

Of course, the effect on hours of work is only one dimension, and probably not the most important one, of the effects of taxes and welfare state spending on labor supply. High marginal tax rates imply a substitution effect in favor of low work intensity, so-called "on-the-job leisure", as well as substitution effects in favor of barter of goods and services at the expense of work for money income. The financial reward to labor mobility also tends to fall. In addition, there is a substitution effect away from investment in human capital if the tax system is progressive, though this effect has been mitigated in Sweden by government subsidization of higher education.

A perhaps more worrisome effect is that there is a substitution effect in favor of the search for tax loopholes, which means that much human intelligence is devoted to rather unproductive activities. Even more worrisome is the huge incentives to tax cheating and other economic crimes, as the return to all types of criminal activities, for obvious reasons, is tax-free -- except for stochastic punishment if the offender is caught and prosecuted.

High marginal tax rates also create distortions in the returns to saving and investment, in particular as the leverage of various asymmetries in the taxation of different types of assets goes up by higher marginal tax rate (as well as by inflation). It is also well known that a combination of high marginal income taxes, high wealth taxes and
high inheritance taxes (as in Sweden) make life very difficult for family firms. This is, most likely, an important explanation as to why small and medium size firms do not expand much in Sweden, even though a number of very small consulting firms (often with no employees) have been created partly for tax reasons (to exploit favorable treatment of deductions and capital gains). 7

It is extremely difficult, perhaps impossible, to quantify the effects of these distortions on the level and rate of growth of GNP. However, it is a rather common opinion (judgement) among both economists and politicians in Sweden today that the rather weak performance of productivity growth in Sweden during the last decades is related to these distortions. 8

Government price regulations have also been used to influence the distribution of income and wealth, the most obvious examples being the price regulations in agriculture and housing. The side effects of such regulations on the allocation of resources are wellknown, and the Swedish experience does not differ much from the experience of other countries that use such regulations. More generally, the experiences of price regulations in housing and agriculture illustrate the costs of pursuing

---

7 There are, of course, also "income effects" of taxes, and these work in the opposite direction of the substitution effects. However, the tax distortion of the allocation of resources are connected to the substitution effects rather than the income effect. Moreover, the income effects of taxes tend to be counteracted by the income effects of the public expenditures that are financed by the taxes, though the net income effects vary, of course, among income groups, depending on who is net gainer and net loser in the redistribution game.

8 There have been various attempts to quantify these effects. For instance, according to one study (based on production functions and attempted "consensus estimates" of supply elasticities) the marginal costs of public funds of the progressive income tax system is 3-7 dollars per dollar of tax revenues, used to finance transfer payments (Hansson 1984). However, due to the complexity of the issue, such calculations must be regarded as "measurement experiments" rather than as reliable estimates.
redistribution policies by way of administrative interventions in the price system -- a type of experiences that has, evidently, been much more profound in socialist countries.

**Service production of the public sector.**

Even though the high ambitions of employment and redistribution policies distinguish Sweden from other OECD countries, perhaps the most important "system difference" may nevertheless be found in the huge resources that are devoted to public sector production and distribution of services to Swedish households. In fact, practically all service production in the fields of education, health care, child care and old age care in Sweden have been taken over, and indeed monopolized, by the public sector.

It is not clear why this has happened. One reason is probably that politicians were anxious to achieve an egalitarian distribution of such services, as well as to control the quality of the services. It seems to be believed that this is simpler if the public sector not only subsidizes the consumption (or production) of such services but also produces and distributes them itself. (It is doubtful, however, if this has been achieved for all types of government services; for instance the children of low-income groups are distinctly under-represented in municipal day care centers.)

Another reason seems to be ideological: an explicit goal of many welfare state proponents in Sweden has been to *socialize* important functions of the family, in particular child care; Alva and Gunnar Myrdal, and the politically influential group around them, were very energetic in arguing for such socialization. The idea probably harks
back to so-called "utopian socialists" of the 18th and 19th century, who dreamed about collectivization of the family.

We may say that a characteristic feature of a welfare state of the Swedish type is that it is the family, or rather the service production of the family, which has been socialized -- rather than firms, which was the socialist ambition, in the tradition of Karl Marx. Moreover, at the same time as the public sector has taken over various services to family members, the family has, as indicated earlier, been increasingly stimulated by high marginal tax rates to take over the repair and maintenance of houses, summer cottages, and durable consumer goods. In other words, the combination of socialized service production and high marginal tax rates means that the family has increasingly assumed responsibility for "the service of things", while the government has largely taken over "the service of human beings". Thus, there has been a substantial change in the division of labor between the family, the market and the government. (Lindbeck 1988a.)

These developments have also had important consequences for the freedom of choice of the family. The redistribution of income in favor of low-income groups has increased the freedom of choice of these groups in the sense that they have obtained larger resources than otherwise to buy goods and services. However, on an individual level high marginal tax rates have drastically reduced possibilities of the individual, in all income groups, to an effective trade-off between income and leisure, as the individual is allowed to retain only 20-30 per cent of the return on increased work effort (Lindbeck, 1988b).

Freedom of choice has also been curtailed by the monopolization of services to households, as there are hardly any alternatives available to the individual. There is also rather general agreement among Swedish
observers that these services are often produced with strikingly low efficiency, probably due to the huge bureaucratization of the public sector, not only within the service producing units themselves but also above and around them. Indeed, the examples of bureaucratization associated with the production of public sector services abound today. One striking example is the heavily bureaucratised regional administrative organisations "above" the hospital system ("Landstingen"). Another example is that since the mid-sixties, the number of employees per pupil in the school system has doubled, without statistically observable improvement in school achievements by the pupils. It may also be mentioned that the costs per child in the municipal day-care centers are currently about 12-18,000 dollars; the number of children per employee is only about three to four. These anecdotal evidence is quite consistent with the earlier mentioned studies which indicate a negative rate of labor productivity growth trend in the public sector as a whole.

Summary evaluation

A "global" view of the consequences of employment policies, redistribution policies and government service production in Sweden may be obtained by comparing the number of persons who are taxfinanced and marketfinanced today. This is illustrated in Table 1 below. While there were 76 taxfinanced citizens per 100 marketfinanced in 1970, the corresponding figure was 132 in 1989. It is open to serious doubt, if this is sustainable, considering the very heavy tax burden of people working in the market sector.
### Table 1

**Number of persons in non-market activities vs market activities**

<table>
<thead>
<tr>
<th></th>
<th>1970</th>
<th>1989</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Public administration and services</td>
<td>806 000</td>
<td>1 427 000</td>
</tr>
<tr>
<td>2. Old age pensioners</td>
<td>947 000</td>
<td>1 544 000</td>
</tr>
<tr>
<td>3. Unemployed</td>
<td>59 000</td>
<td>62 000</td>
</tr>
<tr>
<td>4. Employed in labor market programs</td>
<td>69 000</td>
<td>144 000</td>
</tr>
<tr>
<td>5. Early retirement</td>
<td>188 000</td>
<td>355 000</td>
</tr>
<tr>
<td>6. Sick leave</td>
<td>264 000</td>
<td>317 000</td>
</tr>
<tr>
<td>7. Leave for parenthood</td>
<td>28 000</td>
<td>126 000</td>
</tr>
<tr>
<td>8. Total 1-7</td>
<td>2 361 000</td>
<td>3 975 000</td>
</tr>
<tr>
<td>9. Employed in market sector(^1)</td>
<td>3 106 000</td>
<td>3 020 000</td>
</tr>
<tr>
<td>10. Ratio of 8 to 9</td>
<td>0.76</td>
<td>1.32</td>
</tr>
</tbody>
</table>

* Statistics from various official sources.

\(^1\) Includes public sector corporations and public utilities.

What then are the specific lesson from the Swedish experience? Is there anything that can be learned for other countries -- including other market economies as well as non-market economies where attempts are now made to shift to a market system and private ownership? Perhaps the main lessons can be summarized in the following seven points.

(i) A trivial but important observation from the "small-government period", from about 1870 to about 1950 (and perhaps even to 1960 or 1970), is that a liberal economic regime, with stable and well-defined property rights, and with a "traditional" division of responsibilities between the government and the private sector, may be quite conducive to economic development -- as has, of course, also been proven by the experience of other Western countries.

(ii) It seems to be possible to combine such a traditional "liberal" model with quite ambitious income transfer programs, social security systems, and welfare state services to households -- up to a point. The difficult and controversial issue, of course, is the exact
whereabouts of this point, and how to avoid the dynamics of the political process to overshoot it. My personal interpretation is that severe problems did not emerge in Sweden as long as total public sector spending was below about 40, or perhaps even 50, per cent of GNP, including "public consumption" of some 15-20 per cent of GNP. I would not advise any country to go above such figures -- perhaps not even close to them. The Swedish experience also suggests that it is dangerous to create incentives to absenteeism -- for instance due to high marginal tax rates or very generous conditions in the health insurance and early retirement systems, etc.

When discussing incentive problems, it is important to emphasize that there is not necessarily a conflict between efficiency and equality. What has negative consequences for economic efficiency (and economic growth) is marginal wedges between factor incomes and disposable income and hence between the social and private return on effort. Thus, a rather equal distribution of income may not by itself be unfavorable for economic efficiency, to the extent that it is the result of an even distribution of human physical and financial capital. Indeed, we may speculate that if wealth, and hence also factor incomes, is rather evenly distributed, the political pressure for distortionary redistributions by way of taxes and regulations may be weaker than in societies with a more unequal distribution of factor income. However, the Swedish experience does not seem to adhere to this hypothesis, as in spite of a relatively even distribution of factor incomes, redistribution policies by way of taxes, transfers and regulations have been more pronounced in Sweden than in other countries.

(iii) The Swedish experience also suggests that open unemployment can be kept down, at least for a considerable period of time, by way of
an expansion of permanent public sector employment, temporary public works programs, temporary subsidies to private employment, public sector financed training programs, early retirement of labor and discretionary devaluations.

However, even though this policy was quite successful during the fifteen year period 1975-90, I doubt strongly that this type of employment policy is sustainable in a long-run perspective. There are several reasons for this. First, when people learn about the likelihood of recurring future devaluations, the employment-enhancing effects of "inflating away" unemployment, from time to time, by way of devaluations may be expected to subside (an application of the so called "Lucas critique" of economic policy analysis). Moreover, there have to be limits to the possibilities of "mopping up" unemployed workers by means of expansion of public sector employment, increased early retirement and selective subsidies. The ensuing waste and misallocation of resources may become too high.

If this judgement is correct, Swedish employment policies may simply have postponed the unemployment problems, i.e., bought time, though for quite an extensive period of time (fifteen years). If so, a break-down of full employment policies, as in Norway in the late 1980s, may very well occur in Sweden in the early 1990s. Though labor retraining programs and nationwide labor market exchange systems, and the coordination of these with a strictly administrated unemployment benefit system, probably is very useful, it seems that "Swedish" labor market policies" (temporary public works programs, training, labor exchange systems and mobility-enhancing policies) have been highly "oversold".

(iv) The financing of the pension system may turn out to have important long-term consequences for the functioning of the economic
system. In particular, the accumulation of government "pension funds", in connection with the government pension system, seems to constitute a permanent temptation for adherents to government ownership to suggest that these funds should be used for large scale purchases of shares in private firms, i.e., to a socialization of assets. This is something that should be considered when government pension systems are designed, as continuing threats of socialization of private firms creates permanent uncertainties about the future economic system.

(v) Government monopolization of service production to households, which employs about 30 per cent of the Swedish labor force, has turned out to be associated with serious efficiency problems similar to those of industries in the socialist countries: heavy bureaucratization, low efficiency, long queues, and severe problems with the quality of output. This should not come as a surprise, as the monopolized service production by the government in Sweden, covering about one third of the labor force, is basically conducted as a centrally planned subsystem of the Swedish economy.

I have also emphasized that the combination of high marginal tax rates, which reduce the possibility of the individual to trade-off different activities (such as consumption for leisure) against each other, and the monopolization of public sector service production seriously curtails the freedom of choice of the individual.

However, there are at least two reasons why these various problems in the government sector in Sweden have been less serious than in the socialist countries. First, in a democracy, people can influence the production activities by way of the "voice" mechanism (voting and public discussion) even though the "exit" option is closed. Secondly, the government service sector in Sweden is imbedded in a competitive market
system, which means that intermediary products are often bought from markets and that the government authorities have to compete for factors of production with the private market sector. However, on the basis of Swedish experiences, I would certainly not recommend government monopolization of service production outside the field of truly collective goods.

(vi) Another potentially serious, and somewhat paradoxical, problem with high welfare state and redistributional spending is that taxes may become so high that the government is no longer able to fulfill its traditional functions very well, i.e. to finance the production of truly collective goods (such as defense, law and order, basic research, culture and higher education), and to provide a good infrastructure (such as transportation and sewage systems). Indeed, there are clear tendencies to a deterioration of the government infrastructure; it may be noted, for instance, that infrastructure investment as a share of GNP has recently fallen to about three per cent of GNP. These experiences are another illustration of the risk of expanding public sector expenditures to "Swedish levels".

(vii) Finally, as high taxes and detailed regulations create strong incentives for individuals to find loopholes, the government tends to change the rules and regulations all the time to close the loopholes, with the result that new loopholes are found and utilized, and new changes in the rules are made, etc. As a consequence, there is considerable instability and uncertainty about the rules of the game in the economic system. This is certainly not conducive to long-term commitments by private agents.
Many of these problems in the Swedish economy are now increasingly recognized in the public discussion. Some actions have recently been suggested, and even taken, to solve some of them. For instance, the tax reform to be implemented in 1991 implies that the marginal rate in the income tax system will be reduced to 30 per cent for about 80 per cent of income earners, and to about 50 per cent for the rest. This means, in fact, that ambitions to redistribute income by way of the tax system are reduced. There is also an emerging consensus that the benefit levels of various social security systems have to be cut to restore work incentives, and hence to achieve a closer relation between effort and income of individuals. Politicians have also declared that tendencies toward higher unemployment in the future will not be fought by devaluations, further expansion of permanent public sector employment, or subsidies to private firms. Moreover, government monopolization of the production of services to households has started to be questioned, even by earlier advocates of this system.

However, it is still an open question today to what extent such retreats are politically possible, in a society where the bulk of voters, as indicated by Table 1, gets nearly all their incomes from the government. There may be "irreversibilities" in social and political processes. If that is the case, the lesson is, of course: be careful with expansion of government spending to begin with!
References


Lindbeck, A. (1988c), "Swedish Industry: In a National and an International Perspective, Skandinaviska Enskilda Banken Quarterly Review, No. 3. 1


